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Corporate Schizophrenia: The Corporation as a Separate Legal Person and an Object of Property

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Abstract

In some contexts corporations are closely identified with their shareholders; in others they are regarded as 'completely separate'. This article explores the nature and historical origins of these schizophrenic ideas, arguing that they underpin contemporary corporate irresponsibility. It suggests that they are attributable to the emergence in the nineteenth century of the perception of corporations as both separate legal persons and objects of property, and to the transformation of the share into a Janus-faced, hybrid legal form which mixes rights in rem with rights in personam. This, it argues, has enabled shareholders to retain some of the key proprietary privileges of 'insiders' (owner-members of companies) at the same time as they enjoy the liability- and responsibility-free privileges of 'outsiders' (creditors external to companies). The paper goes on to suggest that the hybrid nature of shareholding could have taken corporate governance in very different directions and, historically, has done so, leading at times to highly 'financialized' forms of governance and at other times to much more 'socialized' forms. It concludes by exploring the policy implications of the (re)financialized forms of governance that have emerged in recent years.

Keywords

separate corporate personality; financialization; socialization; shares; shareholding

INTRODUCTION

In the autumn of 2005 decisions were handed down in two cases involving Railtrack, the group of companies set up to own and manage the infrastructure of the British railway system following privatization. The first case, decided in September, arose out of a rail crash at Hatfield in October 2000 in which four people died and over 70 were injured. It saw Railtrack's successor company,

Network Rail¹, convicted of breaches of safety rules and fined £3.5 million.² The official report into the accident found the immediate cause to be the fragmentation of a rail due to multiple pre-existing fatigue cracks, but the ‘underlying cause’ was identified as the failure of Railtrack and their maintenance contractor, Balfour Beatty Rail Maintenance Ltd, properly to inspect, maintain and, where necessary, replace damaged rails. These were not isolated oversights: the report documented a litany of management failures by both companies. Indeed, Hatfield was not the first accident to have exposed the safety shortcomings of Railtrack. In 1997 six people died and 150 were injured in a crash at Southall, and in 1999 thirty-one people died and 523 were injured in a crash at Ladbroke Grove. Both disasters were attributed to factors under the company’s control: faulty equipment, poorly located signals, poor maintenance, inexperienced and inadequately trained drivers, the absence of safety-enhancing technologies and so on. It emerged that the cracks at Hatfield had been first spotted two years earlier but that neither Railtrack nor Balfour Beatty had addressed them. The rail eventually broke two weeks before it was scheduled to be replaced. Shortly after, one senior Railtrack manager wrote to the Managing Director of Balfour Beatty Rail Ltd, the parent company of BBRML, admitting that there had been a ‘terrible failure in the total management process involving us and yourselves’.³ Mackay J later described Balfour Beatty’s failure to abide by safety rules as ‘the worst example of sustained industrial negligence in a high-risk industry’ he had ever seen.⁴

¹ Railtrack was sold to the private sector in May 1996. By 2005, it had been replaced by the state-controlled, non-profit company, Network Rail, a company limited by guarantee and formed in 2002.

² None of the manslaughter and health and safety charges brought against employees of Railtrack and their maintenance contractor, Balfour Beatty, resulted in convictions. Balfour Beatty pleaded guilty to a health and safety charge and was fined £10 million, later reduced to £7.5 million for reasons of proportionality.

³ Train Derailment at Hatfield: A Final Report by the Independent Investigation Board, 110

⁴ <http://www.telegraph.co.uk/news/uknews/1519644/Fined-13m-but-Hatfield-rail-firms-given-21m-costs.html>

Judgment was handed down in the second case, *Weir & Others v Secretary of State for Transport & the Department of Transport*, a month later in October. This case also arose out of Hatfield, albeit indirectly, for the crash not only confirmed the safety and engineering problems caused by privatisation, it exposed its financial flaws. After Hatfield, Railtrack, which had shed much of its engineering expertise and know-how in a string of post-privatization cost-cutting exercises, panicked and embarked on a massive re-railing programme, much of it probably unnecessary.⁵ Over 1200 speed restrictions were imposed while checks were carried out and rails replaced, all but bringing the rail network to a standstill. Huge sums were spent re-railing and compensating the train-operating companies, and Railtrack started to haemorrhage money. With debts of over £3 billion and rising, the company was plunged into the red and the value of its shares, which had peaked in November 1998 at £17.68, plummeted. In May 2001, Railtrack Group announced its first post-tax loss and by early June 2001, when its shares were worth about £4.50, the railway commentator, Christian Wolmar was predicting 'the end of the company as a viable independent entity'.⁶ A report commissioned by the company laid out three options: restructuring, renationalisation and receivership. The company favoured the former, but it would have cost the government over £4 billion and the Minister concerned, Stephen Byers, decided against it. Straightforward re-nationalisation was also ruled out. Not only was it ideologically unpalatable to New Labour, it was also potentially very expensive as although the market value of the company's shares stood at under £3, under European rules shareholders would have been entitled to about £8 per share, the average price of the shares over the previous three years.⁷

⁵ Stripped of much of its engineering expertise, Railtrack simply didn't know how many genuine cases of gauge corner cracking there were.

⁶ Christian Wolmar, 'The terminal failure of Railtrack', *Guardian* 7/6/01.

⁷ The shareholders had shares in Railtrack Group plc, whose main operating subsidiary, Railtrack plc, was the company placed into administration. Just prior to suspension, the company's shares were trading at £2.80. The three year average price would have included the £17.68 high of 1998.

Byers opted for receivership and on October 7th 2001 Railtrack plc was placed into administration; trading in Railtrack Group plc's shares was suspended the following Monday.⁸ At the time, the company had over 250,000 shareholders holding about 520 million shares, about 82% of which were held by institutions.⁹ When Byers announced that there would be no compensation, the directors of Railtrack Group plc demanded £3.60 per share – 'a fair value settlement' - and two shareholder action groups were formed.¹⁰ Byers resisted, but the institutional investors instructed Railtrack's directors to start proceedings against the government and warned that failure to pay compensation might put in jeopardy not only private funding for future rail projects but the public-private partnerships so dear to New Labour's heart. The government relented and a deal was struck for compensation of £2.50 per share, which eventually rose to £2.62 paid out in five instalments.¹¹ One of the two shareholder groups, the Railtrack Action Group, accepted the offer, but the other, the Railtrack Private Shareholders Action Group (RPSAG), representing nearly 50,000 shareholders the great majority of whom had holdings of 800 shares or less, was not satisfied.

Egged on by the media, and displaying great determination and persistence, RPSAG raised around £2.5 million to fund an action against the government, followed later by a further £900k to cover possible adverse costs.¹² In December 2003, in the largest class action ever seen

⁸ They had closed at £2.80 per share the previous Friday, valuing the company at £1.46 billion.

⁹ Compared with about 42% on May 1996 when the company was privatized. The shareholders had shares in Railtrack Group plc, whose main operating subsidiary, Railtrack plc, was the company placed into administration.

¹⁰ John Robinson, Railtrack Group chairman, quoted in Louise Butcher, 'Railways: Railtrack administration and the private shareholders, 2001-05', *HC Standard Note* SN/BT/1076, 10/8/2010, p7.

¹¹ The Government were particularly concerned about the reaction of the bondholders and large US institutions holding Railtrack shares. In their internal communications, they displayed some contempt for the small shareholders, who were variously described as 'grannies who might lose their blouses' and 'little old ladies'.

¹² See 'Railtrack Shareholders – What kept us going', *Private Investor*, Issue 109, Dec/Jan 2006, p 3-4

in British law, they issued a writ claiming that Byers had forced the company into administration, engineering what amounted to a back-door re-nationalisation without proper compensation. He was guilty, they argued, of both misfeasance in public office with 'malice targeted at the shareholders of Railtrack Group' and a breach of Article 1 of the First Protocol to the European Convention on Human Rights. The case was heard in the summer of 2005, but was lost. The claim that there had been a *de facto* expropriation of their property was dropped during the course of argument and their other claims were decisively rejected by the judge. Agreeing with those who said that Railtrack was 'frankly, a complete mess' before being put into administration, Lindsay J held that although Byers had lied to the Transport Select Committee, he did not have the intent necessary for misfeasance; the course of action he took was, in the circumstances, understandable. Lindsay also rejected the human rights claim on the basis that the claimants could not be regarded as 'victims' under Article 34 of the Convention.

CORPORATE SCHIZOPHRENIA

The members of RPSAG were motivated by their belief that their property had been stolen. In newspapers, blogs and message boards, claims that the Government's behaviour amounted to an act of 'expropriation' and 'confiscation' were commonplace¹³, as were accusations of 'theft'.¹⁴ One newspaper wrote of the 'great Railtrack robbery'¹⁵, another of shareholders 'whose property was expropriated overnight without compensation'.¹⁶ In Parliament the government was accused

¹³ See, for example, *Financial Times*, 'The costly legacy of allowing Railtrack to fail', 13/7/05; *Telegraph* 1/12/01

¹⁴ See *Daily Telegraph*, 10/10/01, quoting Crispin Odey, Head of Asset Management, a substantial shareholder in Railtrack. He likened it to the 'confiscation' of the property of white farmers in Zimbabwe.

¹⁵ *Telegraph*, 'Even worse journeys', 1/12/01

¹⁶ Alex Brummer, 'Backtrack Byers buys time', *Evening Standard* 26/03/02

of ‘an act of confiscation without compensation’.¹⁷ It is striking, however, that neither RPSAG nor their many supporters in the media, led by the *Daily Telegraph*, were entirely sure precisely what the nature of the ‘expropriated’ property was. Sometimes it was characterised as the company’s shares, which, it was claimed, had been ‘confiscated’ for significantly less than their ‘real’ value. Sometimes, however, the shares were conflated with the assets of the company, which, it was argued, were worth even more.¹⁸ On still other occasions the ‘stolen’ property was identified as ‘the company’ itself. Thus one member of RPSAG asserted that it was ‘clear that we the shareholders owned RTK [Railtrack]’, and another that ‘Railtrack Group owns Railtrack plc and we shareholders own both’.¹⁹ Yet another accused the Government of plotting to ‘steal [the] company from its rightful owners’.²⁰ In similar vein, in one of its comment columns, the *Daily Telegraph* wrote of the ‘expropriation of Railtrack’s owners’.²¹

As many have pointed out, there is no legal basis for shareholder claims to ‘ownership’ of the corporate assets. In law, these are owned by the company as a separate legal entity and shareholders have no direct proprietary interest in them; they own shares, which are essentially

¹⁷ Christopher Chope, HC Deb 13/11/01 vol 374. The Conservative Transport Spokesperson, Alan Duncan, accused the Government of deliberately engineering an ‘artificial insolvency’ to enable renationalisation at no cost: HC Deb 24/10/05, cc30-31.

¹⁸ One message board contributor asked whether there was any ‘real justifiable reason for stealing the assets of a private sector company’; another argued that the Government were guilty of ‘grand theft’ and had ‘stole[n] the assets of a privately owned company for no compensation’: <http://boards.fool.co.uk/possible-amount-of-compensation-9347245.aspx?sort=whole>.

¹⁹ <http://boards.fool.co.uk/possible-amount-of-compensation-9347245.aspx?sort=whole>.
<http://boards.fool.co.uk/railtrack-plc-v-railtrack-group-6956032.aspx?sort=whole>.

²⁰ <http://boards.fool.co.uk/i-am-a-little-slow-this-morning-the-telegraph-9348450.aspx>

²¹ *Daily Telegraph*, ‘The Bad Old Days’, 15/1/2002.

rights to revenues.²² The claim that shareholders ‘own’ the corporation itself is also legally unsustainable. When John Kay used A M Honoré’s analysis of ‘ownership’ to assess the ownership claims of shareholders in public corporations, he concluded that only two of Honoré’s ‘tests of ownership’ were ‘unequivocally satisfied’ (‘and these rather minor’), three were ‘partly met’, and six ‘not fulfilled at all’.²³ Others have reached similar conclusions.²⁴ However, these legal niceties eluded RPSAG and many in the media. They regularly conflated ownership of Railtrack’s shares with ownership of ‘the company’ and/or its assets, hence their anger at the modesty of the settlement and suspicion that there must have been subterfuge of some kind: surely, it was obvious that the company and its assets were worth more than £2.50 per share?²⁵

They can’t be entirely blamed for this. Even when it is recognised that in law the company, not its shareholders, owns the assets, it is regularly asserted that the shareholders ‘own’ the company instead. Indeed, the idea that shareholders ‘own’ companies has become part of our everyday, taken-for-granted ‘common sense’. ‘Back when I was a law student in the early 1980s’, recounts Lynn Stout, ‘my professors taught me that shareholders “own” corporations ... [A]t the

²² It is true that shares give shareholders a residual claim on the liquidated assets of a company on insolvency, but very often there is little or nothing left after the company’s debts and liabilities have been met.

²³ John Kay, ‘The Stakeholder Corporation’, in Kelly, Kelly & Gamble, *Stakeholder Capitalism* (Palgrave Macmillan, 1997)

²⁴ See Todd Sayre, ‘The Myth of Shareholder Ownership and its Implications for Accounting’: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1464148; Paddy Ireland, ‘Company Law and the Myth of Shareholder Corporate Ownership’, (1999), 62 *MLR*, 32.

²⁵ See <http://boards.fool.co.uk/possible-amount-of-compensation-9347245.aspx?sort=whole>. However, a former member of the other shareholder action group explained that they accepted the £2.50 per share offer after ‘independent professionals’ confirmed that ‘the whole company was not worth more than the nominal value of the ordinary shares’ and ‘top barristers’ indicated their ‘chances of success in court were minimal’: <http://boards.fool.co.uk/railtrack-action-group-8986529.aspx?sort=whole>.

time ... this made sense enough to me'.²⁶ The significance of this idea should not be underestimated, for legally unsustainable though it may be, it plays a key role in perpetuating the idea that the principle of shareholder primacy is a simple matter of property right. Thus when the law asserts that directors are legally bound to promote the 'interests' or 'success' of 'the company', this is usually interpreted to mean that they are legally bound promote the interests of shareholders, the corporation's 'owners': company and shareholders are treated as more or less synonymous.²⁷

If the Railtrack cases reveal the legal and common sense tendency in certain contexts to downplay separate corporate personality and identify companies with their shareholders, however, they also reveal the tendency in other contexts to regard them as 'completely separate'.²⁸ It is striking that Railtrack's shareholders - who spent so much time, energy and money fighting for compensation from the government - showed little or no interest in, and certainly didn't mobilise themselves to address, the company's appalling safety record. They clearly didn't see this as *their* responsibility or concern.²⁹ They weren't alone. Just as few attached blame for the financial crash of 2007-08 on the shareholders of the financial institutions involved, or Deepwater Horizon on the shareholders of BP, no one in the media seems to have suggested that Railtrack's shareholders, as opposed to the company's senior managers and the company itself, were in any way responsible for the company's safety record. In this context, the shareholders were notable by their absence: both in law and in everyday consciousness the company and its shareholders were seen and experienced as 'completely separate'. In *Weir* this

²⁶ Lynn Stout, *The Shareholder Value Myth* (Berrett-Koehler, San Francisco, 2012), v.

²⁷ See John Parkinson, *Corporate Power and Responsibility* (OUP, 1993), 74-92.

²⁸ See Gower and Davies, *Principles of Modern Company Law* (9th ed., 2012), 35-38.

²⁹ One RPSAG member wrote: 'And enough of the rants about safety – if BP can safely run a thermal hydrogen cracker 2 miles from the secondary school in Grangemouth, then Railtrack could most certainly run the railways': <http://boards.fool.co.uk/i-think-its-more-appropriate-to-note-that-the-8173639.aspx>.

separation was invoked in different contexts: Keith Rowley QC, counsel for RPSAG, used it to argue that ‘the “sins” of Railtrack, a separate entity, should not be visited on his clients’³⁰, while in judgement Lindsay J used it to reject RPSAG’s claims. If there was any ‘victim’ for the purposes of Article 34 of the European Convention on Human Rights, he concluded, it was the parent company, not its shareholders. To have decided otherwise would have required the corporate veil to be lifted and that was justified only in exceptional circumstances not present in the case at hand.³¹

The Railtrack cases thus throw into sharp relief the schizophrenic – in the sense of inconsistent and contradictory – nature of legal and common sense perceptions of the relationship between public corporations and their shareholders.³² They show that for some purposes the existence of corporations as separate legal persons (‘real’ entities) is taken very seriously indeed. Thus, not only were Railtrack’s shareholders not held legally liable for the company’s misdemeanours, nobody seems to have thought them in any way morally responsible for them either. They also show, however, that for other purposes the existence of corporations as separate legal persons is effectively ignored. Thus Railtrack was widely seen as ‘owned’ by its shareholders, as a ‘thing’ which ‘belonged to’ them – a belief reflected in the claims of RPSAG and its supporters, and in the principle of shareholder primacy and treatment of the interests of

³⁰ See Commons Standard Library Note, SN 01076, ‘Railways: Railtrack administration and the private shareholders, 2001-2005’ (10/8/10): <http://www.parliament.uk/business/publications/research/briefing-papers/SN01076/railways-railtrack-administration-and-the-private-shareholders-20012005>.

³¹ <http://lexisweb.co.uk/cases/2004/june/weir-v-secretary-of-state-for-transport-and-another>

³² In this article the term ‘corporation’ is generally used, as it is in everyday usage, to refer to publicly quoted companies. The everyday use of the term to describe large public but not small private companies, is itself revealing, for it implicitly recognises the separate existence of the former. The schizophrenia alluded to here is rather different from that alluded to by William Allen in his ‘Our Schizophrenic Concept of the Business Corporation’, 14 *Cardozo LR* (1992), 261.

companies as essentially synonymous with those of their shareholders.³³ Indeed, the Railtrack cases not only illustrate the existence of corporate schizophrenia, they also show why it is such a problem, for there clearly was a link between Railtrack's safety record and the legal and common sense identification of the company with its shareholders in some contexts (shareholder 'ownership' and primacy) and their 'complete separation' in others (no shareholder liability or responsibility for corporate debts or malfeasance). As Railtrack's chief executive, Gerald Corbett, candidly admitted after Ladbroke Grove, there was a 'tension between shareholder interests and public service obligations'. 'The only way we can make profits', he explained, 'is by not doing the things we should do to make the railways better'.³⁴ In short, corporate schizophrenia is important not only ideologically but in practice, institutionalising the irresponsibility which characterises our corporate system.

This article explores the nature and historical origins of this schizophrenia - a schizophrenia which has been normalised and absorbed into everyday common sense, and which makes it possible for shareholders to assert, in a manner which is generally seen as perfectly appropriate and legitimate, 'ownership' claims over corporations, while simultaneously bearing

³³ Thus under s 172 of the UK Companies Act 2006, for example, the 'success of the company' is explicitly identified with 'the benefit of the members as a whole'.

³⁴ Interview on the Today programme, BBC Radio 4, 17/12/99, cited in Brendan Martin, 'The High Public price of Britain's private railway', *Public World*, November 2010. In similar vein, *National Commission on the BP Deepwater Horizon Oil Spill* concluded that the disaster was ultimately traceable to a string of decisions to ignore standard safety procedures in order to cut costs: see National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling, *Deep Water: The Gulf Oil Disaster and the Future of Offshore Drilling* (Jan 2011). Railtrack paid good dividends to shareholders, notwithstanding its appalling safety record: the total pay-out in 1999 was 26.3p. After Hatfield, pre-tax profits fell but the company nevertheless announced a 5% first half dividend rise. By this time, however, Railtrack's share price was falling: See 'Railtrack profits a scandal', BBC news 27/5/99; 'Railtrack raises dividend', *Guardian*, 14/11/00; 'Railtrack shares slump but dividend held: <http://citywire.co.uk/money/railtrack-shares-slump-but-dividend-held/a223878>.

and experiencing, in a manner thought equally appropriate and legitimate, no responsibility for the behaviour of those corporations. It explores, in other words, the historical processes whereby, as Colin Mayer puts it, we have ‘developed organizations that are without principles’.³⁵ It argues that this schizophrenia is largely attributable to the way in which the corporate legal form was constructed in the nineteenth century in response to the rise of the joint stock company (JSC)³⁶ and pure *rentier* investment. These processes saw the law relating to JSCs deviate more and more from the principles of partnership and the JSC share transformed into a Janus-faced, hybrid legal form which mixes rights *in rem* with rights *in personam*. This has enabled shareholders to retain some of the key proprietary privileges of ‘insiders’ (owner-members of the company) at the same time as they enjoy the responsibility- and liability-free privileges of ‘outsiders’ (*de facto* creditors, completely separate from it).³⁷ It has not passed unnoticed that the resulting institutional structures are not only rather peculiar but tendentially dysfunctional. Indeed, the twentieth century saw fierce debates about the corporate legal form and the position and status of corporate shareholders within it. This article suggests that for those wishing better to understand some of the key institutional structures and property forms of contemporary finance capitalism, this history and these debates are worth revisiting. They not only highlight the oddity of these structures and the consciousness that has come to accompany them, but remind us that the ‘corporate revolution’ and hybrid nature of shareholding could have taken us in very different direction and,

³⁵ Colin Mayer, *Firm Commitment* (OUP, 2013), 240.

³⁶ The term ‘corporate legal form’ refers here specifically to business corporations.

³⁷ See Jongchul Kim, ‘Identity and the Hybridity of Modern Finance’, 38 *Cambridge Journal of Economics* (2014), 425; Jongchul Kim, ‘The Trust is Central to Understanding of Modern Banking, Business Corporations, and Representative Democracy’, XLIX *Journal of Economic Issues* (2015), 271. Shareholder rights are defined in part by statute and in part by the terms of the share issue and by the company’s constitution. The Companies Acts have long provided comprehensive sets of default terms which have been widely followed. What I describe here is the common position of the corporate shareholder.

historically, have done so, leading at times to highly ‘financialized’ forms of corporate governance, at other times to much more ‘socialised’ forms. The recent reassertion by shareholders of their ownership rights has underpinned a (re)financialization of corporate governance and seen corporate schizophrenia and corporate irresponsibility reach unprecedented levels, as the recent financial crisis has made only too clear.

CORPORATIONS: LEGAL PERSONS AND OBJECTS OF PROPERTY

What are the origins of this schizophrenia? How have we come in some contexts to identify companies with their shareholders, while at the same time regarding them as ‘completely separate’ in others? In search of an answer, I’m going to begin not in 2005 but in 1923 and an article in which a Professor at Harvard Law School, EH Warren, criticised the linguistic skills of ‘English ... legislators, pleaders and judges’. Writing in the context of a discussion of asset ownership in early English JSCs, Warren complained that they had ‘never been strong on corporation grammar’. When a JSC was *unincorporated*, he explained, there was ‘no legal unit distinct from the associates’ and the company’s assets were therefore the ‘joint-stock of th[ose] associates’. When the company incorporated, however, the ‘assets became the property of the corporation and were not held by *it* with others’. Despite this, for Warren, obvious truth, in the early English cases the judges and lawyers ‘commonly spok[e]’ of the assets of incorporated JSCs ‘as though they were the assets of the members and not of the corporation’. They didn’t seem to appreciate that once incorporated a JSC became an ‘it’, a property-owning legal entity quite separate from its shareholders. Instead they continued to identify the corporation with its shareholders and to refer to it as ‘they’.³⁸

Contrary to Warren’s suggestion that in the absence of incorporation there could never be a ‘legal unit distinct from the associates’, business associations had long had a limited legal

³⁸ E H Warren, ‘Safeguarding the creditors of corporations’ 26 *Harvard Law Review* (1923) 509).

existence separate from that of their constituent members as a result of the process of affirmative asset partitioning whereby the property of firms, unincorporated as well as incorporated, came to be treated as a separate estate shielded to some extent from the creditors of the members of the firm as individuals.³⁹ Although this established even unincorporated ‘firms’ as separate entities from their members, it did so only in specific ways and to a limited extent: it did not result in anything resembling the modern conception of separate corporate personality or prevent incorporated firms from being conceptualised as aggregates of individuals and referred to as ‘theys’. Warren’s comments reflected the much more radical conceptual separation that had emerged by the time he wrote – one noted a few years before by Harold Laski when he commented on the tendency to ‘personalise’ the corporation and to treat it not only grammatically as an individual (an ‘it’) but as a ‘real’ entity with an independent existence of its own.⁴⁰ His comments also highlight the fact that the modern conception of the corporation as a ‘completely separate’ legal person is actually premised on the corporation’s *de-personification*, on a conception of it as a legal subject cleansed of shareholders. This conception of the corporation as a ‘disembodied entity’⁴¹ underlay Warren’s emphasis on the fact that corporate assets are wholly owned by the corporate entity and are ‘not held by *it* with others’. As we have seen, however, this fully separate, property-owning corporate person is also now seen as a ‘thing’ which belongs to its shareholders. Today, corporations are thus simultaneously conceptualised as de-personified *legal persons* ‘completely separate’ from their shareholders and as *objects of property* which are ‘owned’ by those shareholders.

³⁹ See Henry Hansmann & Reinier Kraakman, ‘The Essential Role of Organizational Law’ (2000), 110 *Yale LJ* 387.

⁴⁰ Harold Laski, ‘The Personality of Associations’ (1916) 29 *Harvard Law Review*, 404-5. ‘Personalise’ was Laski’s term.

⁴¹ Gregory Mark, ‘The Personification of the Business Corporation in American Law’, 54 *University of Chicago Law Review* (1987), 1441 at 1445

FROM THE PERSONIFIED TO THE DE-PERSONIFIED CORPORATE PERSON

Edward Warren was right. Eighteenth and early nineteenth century English lawyers and judges did identify incorporated companies with their shareholders and refer to them as ‘theys’. He was wrong, however, to attribute this to grammatical or conceptual error on their part, and wrong to assume that this was confined to the English. As Merrick Dodd observed, in the early nineteenth century American judges also ‘frequently refer[red] to corporations as “theys” rather than its’.⁴² Naomi Lamoreaux has confirmed this. During this period, she argues, American judges ‘invariably referred to partnerships in ways that focused attention on the people who made them up rather than on the enterprises as entities’ and ‘often referred to corporations in the same way’. Only in the mid-late nineteenth century and early-twentieth centuries did there emerge a de-personified conception of the corporate entity as a reified property-owning legal person - an ‘it’ ‘completely separate’ from its shareholders. As Lamoreaux says, during this period references to corporations ‘with singular verbs and nouns’ ‘came to dominate, and the plural constructions that typified the first half of the century gradually disappeared’.⁴³

Warren was what we might call a corporate ‘essentialist’ who believed that the creation of a property-owning legal person radically separate from its shareholders was inherent in the act of incorporation, but that this wasn’t immediately recognised. He was not, and is not, alone in detecting ‘early conceptual failure’.⁴⁴ In the UK, for example, LS Sealy similarly argued that the introduction of general incorporation led to the substitution of a ‘metaphysical being’ for a ‘collective organism’, but that only ‘*in due course*’ was the ‘jurisprudential significance of this change ...

⁴² E M Dodd, *American Business Corporations until 1860* (Harvard UP, 1954), 66.

⁴³ Naomi Lamoreaux, ‘Partnerships, Corporations and the Limits on Contractual Freedom in US History: An Essay in Economics, Law, and Culture’, in Kenneth Lipartito & David B Sicilia, *Constructing Corporate America* (OUP, 2004) p 29 at 44-45.

⁴⁴ Robert Flannigan, ‘Shareholder Fiduciary Accountability’, [2014] *JBL*, 1 at 11.

recognised'.⁴⁵ And LCB Gower likewise claimed that it was 'not until *Salomon v Salomon & Co Ltd* at the end of the nineteenth century' that the implications of corporate personality 'were fully grasped even by the courts' and the 'independent legal personality of the company' clearly established. Since then, he says, 'the complete separation of the company and its members has never been doubted'.⁴⁶

History reveals, however, that rather than lawyers and judges struggling to grasp the 'true', unvarying meaning of incorporation, understandings of the nature of the corporate entity and its relationship to shareholders *changed* over time. In the eighteenth and for much of the nineteenth century, incorporating a JSC was *not* seen as bringing into existence a fully autonomous, property-owning legal person 'completely separate' from its shareholders. On the contrary, in both incorporated and unincorporated JSCs, shareholders were regarded as the owners in equity of the assets, and shares regarded as equitable interests in those assets.⁴⁷ Incorporation created a separate legal entity, but this entity was seen as an aggregation of people, the company's members merged into a single, legally distinct body. In the words of one contemporary writer, an incorporated company consisted of 'several individuals, united in such a manner, that they and their successors constitute but one person in law, a person distinct from that of any of the members, though made up of them all...'⁴⁸ This underlay the regular references to corporations as 'theys'. Things had changed by the time Warren wrote. What underlay this shift from a conception of the corporate entity as a *personified legal person* (a 'they') to a conception of the corporate entity as a *de-personified legal person* (an 'it')?

⁴⁵ Sealy L.S. Sealy, *Cases and Materials in Company Law*, (Butterworths, 5th ed., 1992). Check.

⁴⁶ Gower, 4th ed., 1979, 97, 100.

⁴⁷ See Ireland, 'Capitalism Without the Capitalist', (1996) 17 *JLH* 40.

⁴⁸ J.W. Smith, *A Compendium of Mercantile Law*, (Maxwell, 3rd ed., 1843), 81.

A clue is to be found in one of the differences between the US and the UK: what is called 'corporate law' in the US is called 'company law' in the UK. Nowadays, this difference is treated as purely terminological and of little consequence: the subject matters of company law and corporate law are basically the same. Broadly speaking, that is now true. But the historical origins of the difference are revealing. Both 'corporate law' and 'company law' were nineteenth century creations, the first books on which were published at around the same time: Joseph Angell and Samuel Ames' *The Law of Private Corporations Aggregate* appeared in 1832, Charles Wordsworth's *The Law Relating to Railway, Bank, Insurance, Mining and Other Joint Stock Companies* followed in 1836.⁴⁹ But they were rather different in orientation and approach. Like both corporate law and company law texts today, Angell and Ames' treatise was organised around the corporate *legal* form, embracing all businesses with corporate status. Nowadays, of course, this means firms of all economic types, from large multinationals to medium-sized firms to small corner shops, all of which can (and do) become incorporated companies. In the eighteenth and for much of the nineteenth century, however, the term 'company' was an abridgement of 'joint stock company' and as the title of Wordsworth's book suggests, 'company law' (such as it was) was an abridgement of 'joint stock company law'. Crucially, JSCs were originally defined not by reference to their *legal* status but by reference to their *economic* natures: at this time, some JSCs were incorporated, but many were not. Organised around the JSC *economic* form rather than the corporate legal form, Wordsworth's book encompassed all JSCs, incorporated and

⁴⁹ Joseph Angell & Samuel Ames, *Treatise on the Law of Private Corporations Aggregate* (Boston: Hilliard, Gray, Little & Watkins, 1st ed., 1832); Charles Wordsworth, *The Law Relating to Railway, Bank, Insurance Mining, and Other Joint Stock Companies* (Butterworth, 1st ed., 1836; 2nd ed., 1837).

unincorporated, reminding us that 'company law' emerged as a body of law designed for application to JSCs.⁵⁰

The distinguishing characteristics of JSCs were outlined by Adam Smith in *The Wealth of Nations* when he contrasted them with the private partnerships ('private copartneries') that dominated productive activity at this time.⁵¹ The ideally-typical private partnership was based around a small number of closely-related individuals who were active participants in the firm. In law, this was reflected in the principles of mutual agency (whereby partners could bind one another), joint asset ownership (whereby partners were the joint owners of the partnership property), and joint and several unlimited liability. For inactive 'investors' who opted to become partners rather than creditors in search of better returns than those available from government debt and usury-capped loans, unlimited liability was clearly a potential problem. But the prevailing view was that by ensuring that success was rewarded and failure punished, unlimited liability not only accorded with the natural principles of justice and the laws of the market but operated in the public interest by ensuring that firms were run efficiently. The 'partnership system of commerce' was widely regarded as the foundation of British economic success.⁵²

By contrast, the ideally-typical JSC was based around a capital fund and had many more members, most of whom were inactive, their interest in the firm being largely, if not wholly,

⁵⁰ The same was essentially true of American 'corporate law', though the situation was more complicated because capital was less abundant and individual states more willing to grant corporate privileges to facilitate the formation of firms that would foster development. However, the link between incorporation and JSCs remained: see Angell and Ames, v-vi.

⁵¹ Adam Smith, *Wealth of Nations* (1776, Liberty Fund 1982, ed by Campbell, Skinner & Todd), Volume II, 731-758. The section on JSCs appeared in the 3rd edition, published in 1784, though the material probably existed in draft from as early as 1774: see John Rae, *Life of Adam Smith* (1965), 362.

⁵² See Ireland, 'Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility', (2010) *Cambridge Journal of Economics*

financial. The ‘proprietors’ of JSCs, Smith wrote, ‘seldom pretend to understand anything of the business of the company; ... and give themselves no trouble about it, but receive contentedly such half yearly dividend or yearly dividend as the directors think proper to make to them’.⁵³ As this suggests, JSCs were vehicles not only for productive activity, but for *rentier* investment. As Marx later explained, in a JSC ‘the actually functioning capitalist’ is transformed ‘into a mere manager, [an] administrator of others people’s capital’ and the ‘owner of capital [transformed] into a mere owner, a mere money capitalist’.⁵⁴ Or as *The Times* put it, the JSC was ‘a system of dormant partners’ in which ‘the sole bond of connexion between the proprietors is money’.⁵⁵ It followed that JSCs were characterised by a separation of ownership and management, and by (more or less) freely transferable shares. Indeed, it was the size, nature, and changing character of their memberships that made the possession by JSCs of corporate privileges so desirable.

Smith believed that JSCs, composed of inactive *rentier* shareholders and run by directors managing ‘other people’s money’ were inevitably characterised by ‘negligence and profusion’. They should, therefore, be facilitated and granted ‘exemptions from the general law’ (like limited liability) only in certain circumstances: where the capital required was beyond the capacity of a private partnership; where the risks were unusually great; where the operations of the business could be reduced to a routine; and where there was an identifiable public benefit.⁵⁶ These ideas about the legitimate scope of the JSC shaped state policy and public opinion well into the nineteenth century. Thus, as late as 1840 one finds a series of leading articles in *The Times* denigrating JSC shareholders as wanting to ‘enjoy the profits of trade consistently with the luxury of being sleeping partners’, to ‘share in the profits of trade without knowledge of trade, or any

⁵³ Smith, vol 2, 741.

⁵⁴ Karl Marx, *Capital Vol III* (Lawrence & Wishart, 1977), chap 27, 436

⁵⁵ *The Times*, 9/11/1840

⁵⁶ Smith, 757-58.

education in it; without abilities, without character, without any attention or exertion . . . '. The leaders concluded that shareholding was 'a means or making money in idleness' and that JSCs were 'inconsistent with the solid and proper principles of trade'; they 'contradict[ed] the proper principles of partnership'.⁵⁷ The persistence of such views meant that throughout this period corporate privileges were granted only sparingly, forcing many JSCs to operate as unincorporated concerns, hence the scope of Wordsworth's book.⁵⁸ It is nevertheless clear that from their inception JSCs were associated with, and linked to, corporate status and privileges, even if not all JSCs were able to secure them. When incorporation and limited liability were made freely available the link became even stronger, for thereafter nearly all JSCs were legally obliged to incorporate. As a result, in the business context, the JSC and the corporate legal form became more or less co-extensive. It was only towards the end of the nineteenth century and the rise of the 'private' company that the link was broken. Thereafter, 'company law' came to encompass not only JSCs but all incorporated firms, irrespective of their economic natures.

THE CHANGING NATURE OF THE JSC AND JSC SHAREHOLDING

History shows that the shift from a personified to a de-personified conception of the corporate entity and the emergence of the modern doctrine of separate corporate personality occurred in the second half of the nineteenth century when company law was closely associated with the JSC economic form and, indeed, being developed to accommodate it. Moreover, they occurred during a period in which the nature of the JSC was itself undergoing significant change. It is these changes, which were as much economic as legal in nature, that we need to explore if we wish to understand the emergence of the de-personified conception of the corporate entity.

⁵⁷ 9 October 1840; 22 October 1840. There was, the paper added, 'only one more quality wanting to make the morsel wholesome as well as tempting' to the idle *rentier* - limited liability.

⁵⁸ See James Taylor, *Creating Capitalism*

In empirical reality, in the late eighteenth and early nineteenth centuries the line between the private partnership and the JSC was less clear than Smith's analysis suggested. Many firms with some of the features of a JSC emerged: relatively large memberships, a separation of ownership and management, and relatively freely transferable shares. Some of these firms were incorporated, some not. But many of them were more in the nature of 'extended partnerships' than 'pure' JSCs, many of their shareholders having more than a purely financial interest in the firms concerned.⁵⁹ Indeed, even if they aspired to be pure money capitalists, JSC shareholders faced objective barriers, for there was no developed market for shares and many companies imposed significant restrictions on share transfers - because shares were only partly paid up, the financial wherewithal of new members was potentially important. There were also significant legal barriers to free transferability.⁶⁰ The result was that shares simply weren't the liquid assets they are today and there remained important senses in which shareholders were 'tied' to companies and couldn't become pure money capitalists even if they wished to. These material realities were reflected in the tendencies, which continued well into the nineteenth century, to regard *all* JSCs (incorporated and unincorporated) as types of partnership, to depict shareholders as 'partners', and to conceptualise JSCs as aggregates of individuals ('theys'). In the jargon of the day, they were 'public, rather than 'private', partnerships - quantitatively rather than qualitatively different. Equally importantly, throughout the eighteenth and early nineteenth centuries shares in both incorporated and unincorporated companies were regarded as equitable interests in the company's assets.⁶¹

The second half of the century, however, saw the emergence of much 'purer' JSCs and much 'purer' money capitalist shareholding. This development was initially driven by the rise of railway companies which needed to raise huge amounts of capital by contemporary standards

⁵⁹ See Mark Freeman, Robin Pearson & James Taylor, *Shareholder Democracies* (2012).

⁶⁰ See *Duvergier v Fellowes* (1828), 5 Bing 267, per Best C J.

⁶¹ See Paddy Ireland, 'Capitalism without the capitalist', 17 *JLH* (1996), 40

and had therefore to cast their investment nets very wide. The result was the emergence of companies populated by thousands (rather than tens or hundreds) of members, many of whose interest was purely financial. This generated a rapid growth in pure *rentier* investment and the emergence for the first time of a developed market in JSC shares. Having previously been dominated by government securities, by the mid-1840s the business of the Stock Exchange had, in the words of one contemporary observer, been 'perfectly revolutionised'.⁶² As shares became increasingly liquid assets, they were gradually endowed 'completely with the character of money capital'.⁶³

The changing character of the JSC and JSC shareholding prompted a series of changes to the law of partnership as it was applied to JSCs⁶⁴, the cumulative effect of which was to accommodate and offer protection to the growing number of pure *rentier* investors. In Robert Flannigan's words, a 'sustained effort' was made 'to design ... arrangements that exposed passive investors to something less than the general liability of principals'.⁶⁵ In this context it was not insignificant that more and more of the law-makers, legislative and judicial, were themselves becoming members of the shareholder class. The legislative changes, and in particular the introduction of incorporation by registration and general limited liability, are well-known. However,

⁶² D M Evans, *The City, or The Physiology of London Business* (1845). See also Paddy Ireland, 'Capitalism without the Capitalist', 17 *Journal of Legal History* (1996) 40.

⁶³ Rudolf Hilferding, *Finance Capital* (1910, Routledge ed., 2007), 109. On the tendency of capital to seek liquidity, see Lorraine Talbot, 'Why Shareholders Shouldn't Vote', 76 *Modern Law Review* (2013), 791.

⁶⁴ By the closing decades of the century the law on JSCs, previously regarded as a branch of the law of partnership, had deviated so much from the principles of partnership that 'company law' had come to be seen as an autonomous legal category in its own right. In 1888 Nathaniel Lindley marked this by splitting his celebrated text on partnership into two separate books: one on the law of partnership, the other on company law. See Paddy Ireland, 'Property and contract in contemporary corporate theory', 23 *Legal Studies* (2003), 453.

⁶⁵ Robert Flannigan, 'The Political Imposture of Passive Capital', (2009) 9 *Journal of Corporate Law Studies*, 139 at 146-47.

a series of judicial changes were also made to the law of partnership as it applied to JSCs. The 1840s, for example, saw the abandonment of the partnership doctrine of mutual agency⁶⁶ and the reformulation of the doctrine of ultra vires.⁶⁷ Crucially, JSC shares were also reconceptualised to reflect the increasingly *rentier* nature of shareholding, coming to be seen as intangible personal property in the form of rights to profit.⁶⁸ This was a very significant shift.

As we have seen, shares in all JSCs, incorporated and unincorporated, were originally seen as equitable interests in the company's assets.⁶⁹ Like partners, therefore, shareholders were seen as having a direct proprietary interest in the firm's property, including any land it happened to own. Because of the rules on passing interests in real estate, this potentially complicated share transfers. JSCs were also seen as aggregates of individuals, with the result that shareholders were seen, in principle, as parties to any contracts companies had entered into: shares were, in part, shares in those contracts. This was an even bigger barrier to assignability, for in the absence of statutory authority contractual liabilities and burdens could not be assigned without the consent of the other contracting party.⁷⁰ The decision in *Bligh v Brent* in 1837, however, marked the

⁶⁶ *Burnes v. Pennell* (1849) 2 HLC 497.

⁶⁷ *Colman v E Counties Railway* (1846), 10 Beav 1.

⁶⁸ *Bligh v Brent* (1837) 2 Y&C 268. See Ireland, 'Capitalism without ...'.

⁶⁹ Shares are, of course, still referred to as 'equity'.

⁷⁰ As Best CJ explained in *Duvergier v Fellowes* (1828), the attempt to create transferable shares without public authority was 'not so much illegal as legally impossible'. When it was said that shares were to be transferable, it had to mean 'that the assignee was to be placed in the precise situation that the assignor stood in before the assignment; that the assignee was to have all the rights of the assignor, and to take upon him all his liability'. In fact, however, 'the assignee [could] join in no action for a cause of action that accrued before the assignment', for such rights of action continued to 'remain with the assignor, who, notwithstanding he has retired from the company, will still remain liable for every debt contracted by the company before he ceased to be a member': 5 Bing 248. See also John George, *A View of the Existing Law Affecting Unincorporated Joint Stock Companies* (1825). Acts incorporating JSCs usually provided the necessary 'public authority'.

beginning of a new approach. In *Bligh*, the property of shareholders was conceptualised as money not assets, and shareholders were portrayed, like creditors and unlike partners, as *transferring* ownership of this property (money) to the corporation to invest in whatever assets it thought fit. Although the money was described as having been ‘entrusted’ to the corporation, the assets were conceptualised as being wholly owned, legally and equitably, by the corporation as a separate entity. The shares were mere rights to ‘surplus profit’ and, as such, personal property, irrespective of the nature of the assets held by the corporation.⁷¹ The same reasoning was soon applied to the shares of *unincorporated* JSCs.⁷² Shares were thus disconnected from the company’s assets. The effects of this were paradoxical. On the one hand, shares began to look less like the rights *in rem* of partners – ‘insiders’ who retain ownership of a firm’s assets and continue to carry the responsibilities and liabilities that go with this - and more like the rights *in personam* of creditors - ‘outsiders’ who transfer ownership of their assets and cede responsibility and liability in return for regular money payments and a bundle of (mainly) contractual rights. They had become intangible bundles of contractual and statutory rights with no direct proprietary connection to any tangible ‘things’.⁷³ On the other hand, the disconnection of shares from the company’s assets (including any real estate owned by the company), together with the development of the market for shares and the provisions of the 1844 Act, enhanced their transferability. The result was that although they were now intangible and more contractual in nature, they were also more exchangeable and,

⁷¹ See Baron Alderson’s analysis in *Bligh v Brent* (1837)

⁷² *Watson v Spratley* (1854) 10 Ex. 222; Ireland *JLH*, 57-8.

⁷³ The rights relate mainly to dividends, winding up and voting. The rights are determined, like contractual rights, primarily by the terms of the share issue and by the company’s constitution, though some of them are conferred by statute: See Sarah Worthington, ‘Shares and Shareholders: Property, Power and Entitlements: Part 1’, 22 *Company Lawyer* (2001), 258.

as such, more thing- and property-like.⁷⁴ As the shareholders of Railtrack discovered to their cost, there were now two quite different pieces of property with often very different values - the assets owned by the company and the shares owned by the shareholders.⁷⁵ JSCs, incorporated and unincorporated, were gradually being constituted as separate *property-owning* legal persons, and this enabled them to acquire, in a much fuller sense than before, a legal existence quite separate from that of their (share-owning) shareholders. 'Where there is property', George Dieser later wrote, 'there is personality; where there is no property, there is no personality'.⁷⁶

As part of these processes, JSC shareholders were gradually re-conceptualised as (passive) 'investors' rather than (active) 'partners', as finance-providing 'money capitalists' rather than asset-owning 'industrial capitalists'.⁷⁷ For many years policymakers continued to assume, or hope, that shareholders would at least monitor managers – a hope which persists to this day – but the law increasingly recognised that they were generally ignorant of business and stood outside the company and the process of production. This was reflected in the gradual transfer to directors of the rights and powers traditionally associated with 'ownership'.⁷⁸ *The Times* picked up on this as early as 1840, remarking that companies had become 'means of making money' not only 'in idleness' but 'in compulsory idleness', for in 'public partnerships' of this sort, 'the proprietors are excluded from ... control and all intimate knowledge is kept back from them'.⁷⁹

⁷⁴ The shares of registered companies were declared to be personal property and transferable as such. However, under the Act 1844 the liabilities of former shareholders did not terminate on transfer, continuing in certain circumstances for a further three years: see s66.

⁷⁵ See *Short Bros v Treasury Commissioners* [1948] 1 KB 116.

⁷⁶ George F Dieser, 'The Juristic Person - I', 57 *University of Pennsylvania Law Review and American Law Register* (1908), 131 at 140.

⁷⁷ This is very apparent in Alderson's judgement in *Bligh v Brent*.

⁷⁸ See Freeman et al, especially chaps 4 & 5.

⁷⁹ *Times* 9/10/1840

Although JSC shareholders were gradually giving up most of the rights traditionally associated with ownership, however, they had acquired the privilege of limited liability and retained their residual control rights: even if they couldn't direct directors they could still dismiss them.⁸⁰ Significantly, this was contrary to what many of the advocates of limited liability had sought. They argued not for the introduction of general limited liability but for something resembling the French *société en commandite*, a limited partnership in which passivity was a pre-requisite of being given the privilege of limited liability. In *sociétés en commandite*, the liability of passive *rentier* (or 'special') partners was limited, but that of active, managing (or 'general') partners was not. Limited liability was given to investors only on the condition that they remained passive and inactive; their rights and powers in the firm and ability to intervene in management were strictly limited. If they became more actively involved, they lost their privileged status as 'special' partners and became 'general' partners subject to unlimited liability.⁸¹ For *rentier* investors in these firms, therefore, the price of limited liability was a loss of control rights and relegation to the status of something closer to a creditor than an owner. The belief was that by fixing those in control with unlimited liability and restricting the control rights of those with limited personal responsibility, the risk of irresponsible behaviour would be reduced. The commendatory partnership was a legal form which decoupled limited liability from rights of control, while the newly emerging corporate legal form, which has since spread around the world, combined them.⁸²

THE JANUS-FACED NATURE OF MODERN SHAREHOLDING

⁸⁰ The shareholders' right to elect directors was explicit in the 1844 Act: 7 & 8 Vict, c 110, s26. The Act, however, placed management firmly in the hands of company directors. The parties could alter the allocation of management authority, but 'not so as to enable the shareholders to act in their own behalf in the ordinary management of the concerns of the company otherwise than by means of directors': s27

⁸¹ See Francis Troubat, *The Law of Commandatary and Limited Partnerships* (Philadelphia, Kay, 1853).

⁸² See Hansmann & Kraakman, 'The End of History for Corporate Law' (2000).

As the nineteenth century progressed, then, JSC shareholders gradually became ever more detached from the companies in which they held shares, conceptually, legally, and in economic reality. As this happened, the separate existence of ‘the company’ – its degree of separate legal personhood – grew. At the conceptual level, this was encapsulated in a subtle change in the wording of the Companies Acts. The Joint Stock Companies Act 1856 permitted seven or more persons to ‘form *themselves*’ into an incorporated company, clearly implying that the company was made *of* them, that the shareholders *were* the company. By contrast, the Companies Act 1862 permitted seven or more persons to ‘form a company’, implying that the company was an object external to them, a ‘thing’ made *by*, but not *of*, them. It was not, however, until the final decades of the century and the rise of the fully paid up share that the de-personification and reification of ‘the company’ was not finally concluded.

For much of the nineteenth century, shares carried high denominations and were only partly paid up. Although uncalled capital provided companies with a ready source of additional finance and acted as a comfort to creditors, the residual liabilities attached to shares also meant that links remained between shareholders and companies and, indirectly, between shareholders and the company’s creditors. In the closing decades of the century, these links were all but severed as share denominations fell and residual liabilities were eliminated, a process which was once again facilitated by the courts and legislature.⁸³ The period between 1867 and 1885 was a ‘watershed in the demise of the prevalence of uncalled capital’. By 1885 only about 32% of companies outside the banking, insurance and finance sectors had shares which weren’t fully paid up; by 1913 this had fallen to just 5.4%. The disappearance of residual shareholder liabilities was attributable ‘mainly ... to demand-side pressures from investors’ and to the growing and increasingly prosperous middle classes demanding ‘safe equity’ and a ‘diversified portfolio of

⁸³ See Seymour Thompson, *Treatise on the Liability of Stockholders in Corporations* (Thomas & Co., 1879).

readily marketable stocks'.⁸⁴ The result was that by the turn of the century the process of defensive asset partitioning had been completed. Existing shares were no longer sources of new capital and corporate creditors could look only to the assets of companies in settlement: the *de jure* regime of limited liability had become a *de facto* regime of no-liability. Shareholders really did now benefit from Smith's 'total exemption from trouble and from risk': all they stood to lose was the money spent on their shares.⁸⁵ Indeed, as early as the 1870s wealthier shareholders were beginning to delegate not only management of companies but management of their money, diversifying their holdings and spreading their risks in investment trusts.⁸⁶ Corporate shareholding had come to comprise ownership of an unencumbered, free-standing right to revenue, external to the process of production and entailing no responsibilities or liabilities, contractual or otherwise, to the company or third parties.

The elimination of residual shareholder liabilities prepared the way for the emergence of the doctrine of separate corporate personality in its modern form by removing the remaining liability links between companies and shareholders and establishing the incorporated company as a fully separate property-owning legal person. Shareholders had, however, retained not only their rights to the residual profits but their residual control rights over this now de-personified legal entity, and this gave rise to the idea that the company was an object of property that they 'owned' and that the interests of 'the company' were (more or less) synonymous with those of its owner-shareholders. Shareholders had acquired a 'novel status'⁸⁷ in which they were simultaneously 'insiders' with residual proprietary control rights able to elect and dismiss directors and insist that

⁸⁴ See Acheson, Turner & Ye, 'The character and denomination of shares in the Victorian equity market', *Economic History Review*, 65, 3 (2012) pp 862- 886.

⁸⁵ See Paddy Ireland, 'Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility', (2010) 34 *Cambridge Journal of Economics*, 837.

⁸⁶ See Arthur Scratchley, *On Average Investment Trusts* (London, Shaw and Sons, 1875).

⁸⁷ Robert Flannigan, 'Shareholder Fiduciary Accountability' [2014] JBL, 1 at 6.

the company be run in their interests, and 'outsiders' who, like creditors (and unlike partners), had transferred ownership of their property to the company and were now responsibility- and liability-free, standing only to lose the money they had invested. The Janus-faced nature of shareholding is vividly reflected in the difficulties company lawyers have capturing the legal nature of the share. One of the most oft-cited definitions, that provided by Farwell J in *Borland's Trustee v Steel Bros & Co Ltd*, tries to encompass both the proprietary and contractual dimensions of the share. According to Farwell, the share is 'the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* ... [It] is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount'.⁸⁸ Others have followed Farwell in foregrounding the contractual dimensions ('liability', 'covenant') of shares while noting their proprietary dimension ('interest'). Thus, for Robert Pennington shares 'are simply bundles of contractual and statutory rights which the shareholder has against the company'. Pennington is aware that this seems to suggest that the relationship between shareholders and companies 'is that of creditor and debtor', but assures us that this is 'quite wrong'. Being transferable, he says, the contractual rights which make up the share are of 'a peculiar nature', and this has led to them being called property. Slightly discomforted by this, but not wanting to dismiss it out of hand, Pennington says this view is 'innocuous enough, provided that it is remembered that they do not comprise any proprietary interest in the company's assets'. Pennington concludes that shares are 'a species of intangible movable property which comprise a collection of rights and obligations relating to an interest in a

⁸⁸ [1901] 1 Ch 279 at 288.

company of an economic and proprietary character, but not constituting a debt'. This covers all the bases but is about as clear as mud.⁸⁹

Others, struggling with the same problem, have placed much greater emphasis on the proprietary qualities of shares. Gower, for example, thought Farwell's definition 'perhaps [laid] disproportionate stress on the contractual nature of the shareholder's rights'. To counter this, he highlighted Farwell's claim the shareholder has an 'interest *in* the company', arguing that this underlined the 'insider' status of shareholders by constituting them 'members of the company'. He recognised that it was 'tempting to equate shares with rights under a contract', but insisted that a share was 'something far more than a mere contractual right *in personam*'. It might not be possible to classify 'the rights which a share confers on its holder ... as "proprietary" in the usual sense', but it was clear that 'the share itself is an object of *dominion*, i.e. of rights *in rem* and not so to regard it would be barren and academic in the extreme'. For all practical purposes shares are recognised in law, as well as in fact, 'as objects of property which are bought, sold, mortgaged and bequeathed.' As Gower recognised, however, this mixing of rights *in rem* with rights *in personam* did not make it easy to specify the precise nature and basis of this proprietary interest: 'The theory', Gower argued, 'seems to be that the contract constituted by the articles of association defines the nature of the rights, which, however, are not purely personal rights but instead confer *some sort of* proprietary interest in the company though not in its property'.⁹⁰ Recently, this view was explicitly endorsed by Lord Miller in *HM Commissioners of Inland Revenue v Laird Group plc*. 'It is customary', Miller argued, 'to describe [a share] as "bundle of rights and liabilities" and this is probably the *nearest one can get to* its character, provided that it is appreciated that it is more than a bundle of contractual

⁸⁹ Robert Pennington, *Company Law* (London, Butterworths, 7th ed., 1995), 56-57, 135-36; Robert Pennington, 'Can Shares in Companies be Defined?' (1989) 10 *Company Lawyer* 144.

⁹⁰ Gower (4th ed 1979), 299-301, 400.

rights .. These rights ... are not purely personal rights. They confer proprietary rights in the company though not in its property'.⁹¹

Gower was well aware, however, that it isn't easy to distinguish shareholders from debenture holders.⁹² He conceded that the rigid *theoretical* separation between shareholders with rights in the company as well as against it, and debenture-holders with rights against the company but never in the company itself, collapsed in contemporary 'economic reality'.⁹³ Sealy agrees, arguing that the 'theoretical differences between being a creditor of the company and being a member are considerable from a legal point of view, but (at least in the case of a solvent and prosperous company) the practical consequences for investors, apart sometimes from tax considerations, are very similar an investment in debentures or debenture stock is very similar to an investment in shares: both are securities in the corporate sector of the economy offering different kinds of risk and different kinds of return'.⁹⁴ In other words, they are both money capitalists, external to companies and to the production process itself.

The share's mixing of insider and outsider rights, of rights *in rem* with rights *in personam*, lies at the heart not only of contemporary corporate schizophrenia but contemporary corporate irresponsibility, for it gives shareholders residual control rights which enable them to ensure that companies are run in their exclusive interests, while at the same time detaching them, like creditors, from companies. Shareholders and their institutional representatives are able to enjoy revenue rights without actually doing anything and able to insist (as 'owners') on the maximisation

⁹¹ UKHL 54 at para 35

⁹² Legally, Robert Flannigan suggests, the debt-equity distinction is rooted in liability questions: the 'default financial position of shareholders is similar to that of debt holders: both have capped exposures that prevent recourse to other personal assets': Flannigan, 'The Debt-Equity Distinction' (2011) 26 *BFLR*, 451 at 454; 'Shareholder Fiduciary Accountability' [2014] *JBL*, 1 at 10.

⁹³ Gower, 299-301, 321.

⁹⁴ L.S. Sealy, *Cases and Materials in Company Law* (London: Butterworths, 6th ed 1996), 420-421.

of those revenues without having to worry about how they are generated, safe in the knowledge that, like creditors, they aren't legally responsible for corporate misbehaviour and only their initial investments are at risk in the event of failure. As Harry Glasbeek says, corporate shareholders 'have little financial incentive to ensure that the managers involved behave legally, ethically, or decently . . . [because] in law, [they] are personally untouchable. . . ' ⁹⁵ This was, of course, only too evident in the Railtrack cases and, more recently, in the financial crisis.

THE TRIUMPH OF THE CORPORATE LEGAL FORM

The late nineteenth and early twentieth centuries saw rapid growth in the number of JSCs, driven partly by advancing technology and rising capital needs but primarily by the desire of businessmen to eliminate competition. The 'Great Depression' of 1873–96 saw firms respond to chronic overproduction, severe price cutting and falling profits by trying to fix output and prices. They did this initially through Trade Associations, trusts, cartels and other similar devices, but when these failed (as they almost invariably did) they resorted to mergers, forming large corporations able to influence, if not control, markets. These processes, associated with the 'rise of the corporate economy'⁹⁶, underlay a rapid growth in the number of corporate shares. The rise to dominance of the de-personified JSC was thus part and parcel of important changes in the nature of capitalist social property relations – changes in which ownership of intangible financial property became ever more central and important.

At the same time the corporate legal form was increasingly adopted by small firms not organised on a joint-stock basis. Although the Companies Acts 1844–62 were clearly intended to be used only by JSCs and for many years generally were, the 'Great Depression' saw more and more sole traders and small partnerships incorporate under the Acts to get limited liability. Some

⁹⁵ Glasbeek, *Wealth by Stealth* (Toronto, Between the Lines, 2002), 129.

⁹⁶ See Leslie Hannah, *Rise of the Corporate Economy*

doubted the legitimacy and legality of this practice but in the celebrated case of *Salomon v. Salomon & Co Ltd*, the House of Lords, overturning the decision of the Court of Appeal, held that Salomon's one-man company was a 'completely separate' entity from Salomon himself.⁹⁷ The radical legal separation of companies and shareholders, developed in the specific context of JSCs populated by large numbers of passive detached *rentier* shareholders, was thus extended to 'private' companies that were, in reality, often nothing more than incorporated individual proprietorships and partnerships. It was not long before most significant business enterprises were incorporating, whatever their economic natures.⁹⁸

Equally importantly, when corporate groups began to emerge for the first time, the *Salomon* principle was formalistically extended to them. This has made possible and, indeed, encouraged the construction of complex groups in which each company enjoys limited liability. Rigid adherence to *Salomon*, coupled with *de facto* no-liability shareholding, has thus greatly extended the scope for opportunistic behaviour and provided an institutional foundation for systemic irresponsibility: as Beth Stephens says, 'multiple layers of control and ownership insulate individuals from a sense of responsibility for corporate actions'.⁹⁹ Today, the economically most powerful firms are multinational *enterprises* made up of many connected companies. In law, the existence of these enterprises is given only limited recognition: each company in the group is regarded for most legal purposes as a separate entity. In principle, therefore, those dealing with one company have no rights against the other group members, even though the organisation as a whole is usually co-ordinated by a single management team. The resulting structures are complex, involving subsidiaries, cross-holdings, joint-ventures and the like, though it is usually the

⁹⁷ *Salomon v Salomon & Co Ltd* [1897] AC 22.

⁹⁸ See Paddy Ireland 'The rise of the limited liability company' (1984) 12 *International Journal of the Sociology of Law* 239.

⁹⁹ Beth Stephens, 'The Amoralism of Profit', 20 *Berkeley Journal of International Law* (2002), 45 at 46.

same mechanism that is at work: direct or indirect control through shareholding. Because these enterprises can choose where to locate different parts of their activities, competition has emerged between states as they strive to create favourable legal and regulatory environments to attract investment. This reaches its apotheosis with tax laws, as enterprises locate their profits in low-tax jurisdictions and states trade their sovereignty in the legal marketplace.¹⁰⁰

The rise of private and subsidiary companies has also fuelled the myth of shareholder corporate ‘ownership’. In large public companies populated by detached *rentiers*, there is not only little or no *legal* basis for the idea that they are ‘owned’ by their shareholders, there is usually little or no *de facto* basis for it either, notwithstanding shareholder retention of residual control rights. In the case of private companies and subsidiaries, however, the ‘ownership’ claim usually has much more *de facto* substance, for although the ‘complete separation’ of company and shareholders is legally very real for liability purposes, it is often entirely fictional in empirical reality so far as control of corporate assets is concerned. This has contributed to the entrenchment of the idea of shareholder corporate ‘ownership’ in everyday common sense, even in situations where it lacks *de facto*, as well as legal, substance.

THE ‘CORPORATE REVOLUTION’: TOWARDS SOCIALIZATION OR FINANCIALIZATION?

The peculiarities of the institutional forms that emerged from all this did not pass unnoticed by late nineteenth and early twentieth century observers. Nor did the changes they wrought in the social relations and dynamics of capitalism. However, they sparked rather different ideas about and visions of the future. Some saw the corporate revolution as leading towards the ‘socialization’ of production; others towards its ‘financialization’. History suggests that the nature of the JSC and JSC shareholding made both possible. Things could have gone either way and at different times

¹⁰⁰ See Jean-Phillipe Robé, ‘Globalization and the Constitutionalization of the World-Power System’, in Robé, Lyon-Caen & Vernac (eds), *Constitutionalization of the World-Power System* (forthcoming, 2015).

they did, depending largely on the ability (and desire) of shareholders to exercise their residual proprietary rights. Contrary to the claims of contemporary advocates of ‘evolution to efficiency’¹⁰¹, the directions taken were as much the product of political struggles and institutional changes as of economic or technological imperatives. It was by no means inevitable that we would end up where we are today. Indeed, the twentieth century saw many challenges to the prevailing arrangements. The peculiar nature of the share and the odd status and position of the *rentier* shareholder lay at their heart, as did the latter’s dubious claims to corporate ‘ownership’.

Some saw the rise of the JSC as an essentially progressive development, a step on the road to the socialisation of production. Echoing Smith, for example, Marx observed that in JSCs ‘the owner of capital’ was transformed into ‘a mere money capitalist’ who received dividends in the form of interest - as ‘mere compensation for owning capital’ that was ‘entirely divorced from function in the actual process of production’. Clearly sensing the increasingly creditor-like nature of JSC shareholding – Marx commented on the JSC amidst a discussion of the development of the credit system – he argued that the rise of the JSC presaged the emergence of more socialised productive forms. It represented ‘private production without the control of private property’ and ‘the abolition of capital as private property within the framework of capitalist production itself’. JSCs were ‘social undertakings as distinct from private undertakings’ and marked a ‘mere phase of transition to a new form of production’ in which capital would be ‘reconverted’ into ‘the property of producers’, ‘outright social property’. Marx also observed, however, that the development of the credit system was seeing money capital assume an increasingly ‘social character’ as it became concentrated in (and loaned out by) increasingly powerful banks representing ‘all lenders

¹⁰¹ See Mark Roe, ‘Chaos and evolution in law and economics’ (1996) 109 *Harvard LR*, 601; see also Hansmann & Kraakman (2001), ‘The End of History for Corporate Law’ (2001) 89 *Georgetown LJ*, 439–68

of money', acting as 'the general managers of money capital'. 'A new financial aristocracy' was emerging, he argued, as were new 'variet[ies] of parasites'.¹⁰²

While Marx saw the rise of the joint stock corporation as essentially progressive, the American economist and sociologist Thorstein Veblen, writing a few decades later, was less sure. By this time large swathes of American and German industry had come to be dominated by banks and financiers - Marx's 'new financial aristocracy' – using the residual proprietary rights attached to shares. In Germany banks led the way, as Rudolf Hilferding recounted in *Finance Capital*¹⁰³; in the US financiers like J P Morgan were dominant. This was the period of 'the first financial hegemony'.¹⁰⁴ Taking advantage of the increasingly desperate attempts of firms to suppress competition, these financiers arranged merger after merger, reaping massive 'promoter's profits' and came to exercise *de facto* control over corporations with minority shareholdings using a mixture of voting trusts, debt and interlocking directorates. Some, like John Moody, founder of the bond-rating agency, celebrated this development¹⁰⁵, but many were highly critical. Indeed, it was the increasingly direct domination of American industry by a plutocratic financial and industrial elite (the so-called 'money trust') that underlay the Pujo Committee investigations of 1912-13 and Louis Brandeis' fierce attack on the American 'financial oligarchy'.¹⁰⁶ Veblen argued that with the rise of the joint stock corporation, '*industry*', the technical processes concerned with the efficient production of useful goods, had fallen under the control of '*business*' – what we would now call 'finance'. 'Business' was more concerned with making money than things, and managed industrial processes not so much to enhance productive efficiency and maximise output, as to secure

¹⁰² Karl Marx, *Capital, Vol III* (Lawrence & Wishart, 1973), chaps 23, 25, 27.

¹⁰³ Rudolf Hilferding, *Finance Capital* (1909, Routledge ed., 2007).

¹⁰⁴ Gerard Dumenil & Dominique Levy, *The crisis of neoliberalism* (Harvard UP, 2011)

¹⁰⁵ John Moody, *The Truth about the Trusts* (Moody, 1904), discussed in Becht & de Long, 613.

¹⁰⁶ Louis Brandeis, *Other People's Money* (New York: Stokes, 1912)

pecuniary gains for the owners of financial property.¹⁰⁷ 'The financial community', he wrote, 'found themselves in a position to take over and control the usufruct of the country's industrial system by taking over the ownership of [its] strategically dominant members'.¹⁰⁸ Indeed, according to Veblen financial domination often led to the 'conscientious sabotage' of industry, for, larger profits were often to be had from obstructing production than from facilitating and maximising it.¹⁰⁹ Business had become a parasitic growth on industry; investment bankers and corporate financiers had become as restrictive of further economic development as the old landed elite.¹¹⁰

THE CRITIQUE OF THE RENTIER: SHAREHOLDERS AS CREDITORS

By the 1920s, however, investment was spreading among the American middle class and share ownership becoming more widespread and dispersed. At the same time, the direct personal control exercised by financiers like Morgan was gradually being replaced by more impersonal, bureaucratic routines. With this, the focus of Veblen's assault shifted somewhat. He still railed against the consequences of financial domination. 'Business enterprise' and particularly American business enterprise, he argued, 'habitually looks to the short run', sacrificing long-term productive gains in favour of 'an enhanced rate of earnings for the time being'.¹¹¹ But by this time Veblen's attack on finance was turning into a thoroughgoing attack on the legal position of shareholders: the financial interests of these 'absentee owners' was obstructing productive activity and conspiring against the full use of the 'industrial arts'.¹¹² It was in this context that Veblen began to question the remaining 'ownership' rights of shareholders, arguing that the classic liberal

¹⁰⁷ Thorstein Veblen, *Theory of Business Enterprise* (Scribner, 1904), 77–8, 80.

¹⁰⁸ Thorstein Veblen, *Absentee Ownership* (Huebsch, 1923), 231–2.

¹⁰⁹ See Joseph Dorfman, *Thorstein Veblen and his America* (New York, Viking, 1934) 227–8.

¹¹⁰ Thorsten Veblen, *The Vested Interests and the Common Man* (New York: Huebsch, 1919), 97–8, 105

¹¹¹ Veblen, *Absentee Ownership*, 214.

¹¹² Veblen, *Vested Interests*, 97–8, 105.

justifications for absolute property rights simply did not apply to passive, financial property. The new absentee owners of industry had delegated most of the traditional powers of ownership to managers, retaining only certain 'rights and immunities'. 'Ownership' in the new corporate order had been 'depersonalised' and 'no longer carrie[d] its earlier duties and responsibilities'. Corporate shareholders, Veblen argued, now resembled creditors rather than 'real' owners. They were 'anonymous pensioners', whose personal identities were irrelevant 'even to the concern itself' and whose 'sole effective relation to the enterprise [was] that of a fixed overhead charge on its operations'. They were the owners of rights to receive a 'free income' drawn from 'the . . . product of the underlying community'.¹¹³

Commentators in the UK began to echo these views. Although British industry had never fallen under financial control in the same way as American and German industry, there emerged a very similar and equally radical critique of the *rentier* and financialized industrial governance. The Labour Party intellectuals, R H Tawney and Harold Laski, led the assault. In his influential 1921 book, *The Acquisitive Society*, Tawney castigated the inherently pernicious and parasitic nature of intangible financial property forms like the corporate share.¹¹⁴ Like Veblen, he argued that the traditional justifications for private property rights were inapplicable to property of this sort which divorced gain from service, and reward from work. Unlike rights to tangible personal possessions which could be defended as 'indispensable to a life of decency and comfort' and as encouraging industry and individual initiative, these new intangible, passive property forms were 'functionless'. Indeed, in directing productive activity towards 'acquisition' rather than 'service to society', they were positively *dysfunctional*, dissipating creative energy, 'corrupting the principle of industry' and distorting productive activity. To redirect industry along more productively rational and socially beneficial paths, Tawney proposed that the control rights of shareholders be

¹¹³ Veblen, *Vested Interests*, 163-4.

¹¹⁴ R H Tawney, *The Acquisitive Society* (1920)

withdrawn and that they be re-classified as creditors. This, he suggested, would enable industry to be released from financial domination and to be (re)organised in productively more functional ways, and would allow management to be turned into a 'profession' akin to medicine and law.¹¹⁵ A few years later, Harold Laski echoed these sentiments in *Grammar of Politics*, recommending an 'alteration of the character of the owner of wealth into a person to whom a fixed dividend is paid' to enable production to be socialised and 'infused ... with the sense of responsibility it now lacks'.¹¹⁶ Like both Marx and Veblen, then, Tawney and Laski recognised the ways in which the rise of the JSC and financial property forms like the JSC share had blurred the lines between debt and property, between credit and capital, and between rights *in rem* and rights *in personam*. To continue to see shareholders as 'owners', they suggested, was not only legally and morally unjustifiable but likely to lead to productively and socially undesirable, financialized forms of management and governance. Shareholders should be legally constituted as types of creditors – 'outsiders' who were 'owed' but did not 'own'.

Similar ideas figured in the debates between Adolf Berle and Merrick Dodd, and in the closing chapters of Berle and Means' *The Modern Corporation and Private Property*.¹¹⁷ In his debate with Berle, Dodd argued that the great majority of the shareholders in large joint stock corporations were *rentiers* with little resemblance to traditional owners, and that these corporations increasingly had the character not of private enterprises but of *social* or *public* institutions. On this basis, he suggested, it was clearly arguable that directors should be required to take account of the interests not only of shareholders but of employees, consumers, creditors and society as a whole. This radical view was perfectly defensible if you really took seriously the

¹¹⁵ For an earlier expression of this idea, see Louis Brandeis, 'Business – A profession' *System* (October 1912).

¹¹⁶ H Laski, *A Grammar of Politics* (Allen & Unwin, 1925) pp. 201–9.

¹¹⁷ A Berle and G Means, *The Modern Corporation and Private Property* (New York, Macmillan, 1932).

existence of the corporation as a separate legal person¹¹⁸, an idea which, as Berle and Means later noted, had already found expression in Germany in the notion of the 'enterprise as such'.¹¹⁹ Despite his differences with Dodd, which were as much pragmatic as principled, Berle also recognised that the character of both the shareholder and the corporation had radically changed. The final section of *The Modern Corporation* drew on the radical critiques of Veblen, Tawney and Laski to question the applicability of the 'traditional logic' of profit and property in the modern corporate era.¹²⁰ The rise of the modern corporation, Berle and Means argued, had 'dissolved the [private] property atom' in which possession and control were united. There were now two forms of property: one *active*, the tangible assets owned by the corporation and controlled by the managers; the other *passive*, the intangible revenue rights, 'liquid, impersonal, and involving no responsibility', owned by the shareholders. Reduced to a 'mere recipient of the wages of capital', they argued, the modern corporate shareholder was now 'not dissimilar in kind from the bondholder or lender of money'. It followed that it was no longer appropriate to view shareholders as 'owners' (other than of shares) or to view corporations as objects of property. The 'corporate revolution', they concluded, had raised 'legal, economic and social questions' of considerable importance, the 'greatest' of which was 'in whose interests should the great quasi-public corporations ...be operated?'¹²¹

In the final chapter of the book they outlined some possible answers. The first entailed sticking with the traditional logic of property and insisting that corporations be run in the exclusive interest of shareholders 'despite the fact that [they] ha[d] ceased to have power over or accept responsibility for the active property'. The second entailed giving the controlling managers 'free rein'

¹¹⁸ See E Merrick Dodd, "For whom are corporate managers trustees?" (1932) 45 *Harvard Law Review* 1147.

¹¹⁹ An idea popularised by Walther Rathenau: *Vom Aktienwesen, eine geschäftliche Betrachtung* (1918).

¹²⁰ Berle and Means' work is permeated by 'Veblenite echoes': see D.M.Wright, 'The Modern Corporation – Twenty Years After' (1951-52) 19 *University of Chicago Law Review* 662.

¹²¹ Berle & Means, Book IV.

to use their powers as they wished, though this was thought likely to encourage the emergence of a plundering 'corporate oligarchy'. The third involved abandoning the ideas of shareholders as 'owners' and corporations as private property, and developing a 'new concept of the corporation' as a social institution. In becoming functionless *rentiers*, shareholders had 'surrendered the right that the corporation should be operated in their sole interest' and 'released the community from the obligation to protect them to the full extent implied in the doctrine of strict property rights'. The community was now entitled 'to demand that the modern corporation serve ... all society' and that various groups be 'assign[ed] ... a portion of the income stream on the basis of public policy rather than private cupidity'; shareholders should get only 'a fair return' on their capital.¹²² Although Berle clearly sympathised with this conception, he hesitated to advocate it because we didn't yet have the institutional know-how to impose a broader 'scheme of responsibilities' on managers. This led him to urge retention, if only temporarily, of shareholder primacy: it was the only available way of making managers accountable.¹²³

MANAGERIALISM: TOWARDS SOCIALIZATION?

Commentators continued to voice ideas of this sort well into the 1960s. In the US they appeared in the work of J K Galbraith and in the later work of Berle himself; in the UK they appeared in the work of people such as George Goyder and Bill Wedderburn, both of whom argued that shareholders should be formally re-conceptualised as creditors.¹²⁴ They also found indirect expression in the many proposals for worker participation and industrial democracy. They did not, however, result in significant changes to corporate rights-obligations structures, in part because

¹²² Berle and Means, Book IV, chapter IV.

¹²³ Berle, 'For Whom Corporate Managers are Trustees' (1932), 45 *Harvard Law Review*, 1365.

¹²⁴ George Goyder, *The Responsible Company* (Basil Blackwell, 1961). K W Wedderburn, *Company Law Reform* (Fabian Society, 1965)

many on the left did not think there was any need to press for such changes. By this time, with shareholders dispersed and Bretton Woods in place, finance seemed to have been tamed and shareholders disempowered. The managers seemed not only to be in charge but to be subject to social controls and influences. The 'managerial revolution', many believed, was ushering in a new era of 'managerial capitalism' and rendering radical, politically contentious changes to corporate rights structures unnecessary.

In the UK, the idea that the 'socialization' of corporations could be achieved without significant changes to corporate legal form can be traced back at least to the mid-1920s. In Britain, industry had never been dominated by high finance in the same way as in Germany and America, JSC shareholding was more widely spread and dispersed, and the separation of ownership and control more advanced.¹²⁵ The resulting weakening of shareholder control led Keynes to argue that there was an inevitable tendency for 'joint stock institutions, when they [had] reached a certain age and size, to approximate to the status of public corporations rather than that of individualistic private enterprise'. The 'tendency of big enterprise to socialise itself', he argued, was manifested when 'the owners of the capital, i.e. its shareholders, are almost entirely disassociated from the management', at which point managers become more concerned about the stability and reputation of the institution than with profit maximisation, and shareholders have to satisfy themselves with 'conventionally adequate dividends'. It was on this basis that Keynes dismissed the need for overt socialisation. There was 'no so-called important political question so really unimportant, so irrelevant to the reorganisation of the economic life of Great Britain', he argued, 'as the nationalisation of the railways'. 'The battle of socialism against unlimited private profit [was] being won in detail hour by hour' from within these large enterprises.¹²⁶ Ten years later, in

¹²⁵ See Leslie Hannah, 'The Divorce of Ownership from Control from 1900 onwards: Recalibrating Imagined Global Trends' 49 *Business History* (2007), 404. .

¹²⁶ J M Keynes, *The End of Laissez-Faire* (Hogarth Press, 1926)).

The General Theory, after observing that interest rewarded ‘no genuine sacrifice’ and anticipating an end to the scarcity of capital, he famously foresaw the gradual ‘euthanasia of the *rentier*’. By this time he was clearly concerned about the pernicious effects of finance. Echoing Veblen, he warned that investors (and especially ‘professional investors’) tended to seek short-term gain by outguessing the market rather than long-term gain, and that their growing power was causing ‘speculation’ to dominate ‘enterprise’, especially in the US,. This was not only damaging productive investment but acting as a source of economic instability. He concluded that because there was ‘no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable’, the state, which was better placed to take a longer view and to take account of the general social interest, should take greater responsibility for ‘directly organising investment’. To secure ‘an approximation to full employment’ and to channel resources away from speculation towards production, a ‘somewhat comprehensive socialisation of investment’ was required.¹²⁷

The idea that changes to corporate rights structures were not needed to ‘socialise’ the corporation gathered strength after the Second World War. In the 1950s, for example, the leading Labour Party intellectual, Anthony Crosland, insisted that socialist goals could be realised within the existing structures. Passive and dispersed shareholders, acting more like creditors than owners, had neither the desire nor the ability to exercise their control rights. And the rise of monopolies and oligopolies had diminished product market competition and created the space for professional managers to create more ‘socialised’ corporations and a more socialised ‘managerialist capitalism’.¹²⁸ There was no need for outright nationalisation or for radical legal reform. Even when proposals were made for industrial democracy and worker representation on

¹²⁷ J M Keynes, *The General Theory of Employment, Interest and Money* (Macmillan, 1936), chs 12 and 24.

¹²⁸ C A R Crosland, *The Future of Socialism* (London: Jonathan Cape 1956); and *The Conservative Enemy* (London: Cape, 1962).

the boards of large corporations – proposals which would have attenuated shareholder control rights – the response from the labour movement was less than wholehearted. Co-determination, the leading labour lawyer Otto Kahn-Freund argued, could be achieved either ‘in the land of collective bargaining on the pluralistic pattern’ or ‘in the land of company law on the unitary pattern’. He rejected the latter as ‘alien to the TU movement’ and a denial of the fundamental conflict of interest between capital and labour.¹²⁹ However, others thought otherwise, and continued to press not only for industrial democracy but for the formal relegation of shareholders to the status of creditors. Indeed, this suggestion was not confined to the left: some argued for alterations to corporate rights structures along these lines simply to make them better reflect the ‘real’ nature of the corporate shareholder as an inactive *rentier*.

For a while, it looked as though those who believed that ‘socialisation’ did not require radical changes to shareholder rights might be right. A mixture of financial repression, shareholder dispersal, countervailing trade union power, public opinion, and the rise of oligopolistic markets partially liberated managers from both shareholder and market imperatives, making it possible for them to balance the interests of different ‘stakeholder’ groups and to operate in a more socially responsible manner. It is important not to exaggerate these changes, but equally important not to ignore or understate them either. The claim that we were entering an era of more ‘socially responsible corporations’, with manager-technocrats at its heart, which became commonplace in the 1950s and 60s, was not without substance.¹³⁰ Nor is it insignificant that the ‘managerialist’ era overlapped the fifty or so year period after World War One recently identified by Thomas Piketty as one in which wealth inequalities in advanced capitalist countries narrowed. *Les trentes glorieuses* really did see the power of the *rentier* class and finance reduced, and the emergence of more socialised corporations. Corporations were increasingly treated as though they really

¹²⁹ O Kahn-Freund, ‘Industrial democracy’ (1977) 6 *Industrial Law Journal* 65.

¹³⁰ See J K Galbraith, *The New Industrial State* (Hamish Hamilton, 1967).

were separate from their shareholders – and not just for liability purposes. With this, of course, corporate schizophrenia began to wane.

THE NEOLIBERAL REVOLUTION: FINANCIAL POWER AND THE RETURN OF THE SHAREHOLDER-OWNER

Beginning in the 1970s, however, the landscape changed once more. Many things contributed to this, but alterations to the legal rights-obligations structures of corporations were not prominent amongst them: the key characteristics and features of the corporate legal form have changed relatively little in recent decades. This is not to say that the bundle of rights possessed by shareholders has not been enhanced: it has. But many of the enhancements have occurred not in company law but in the rules regulating international capital flows, take-overs, and securities markets: the demise of Bretton Woods and removal of controls over the free movement of capital, the rise of the ‘New Constitutionalism’ and new mechanisms of investor protection and so on. The other main source of change was the transformation of share ownership: the re-concentration of financial property ownership in institutions and the development within those institutions of systems using portfolio managers who are subject to regular market-based performance evaluation. The result is that shareholders as a class are now much better placed to exercise or threaten to exercise their residual (insider) proprietary rights and the power they confer. Re-concentration has enabled finance - money capital acting through its institutional representatives - to re-assert its power in and over corporations, and indeed over the state¹³¹, propelling us back towards the kind of manipulative, finance-dominated world described by Veblen a century ago. Moreover, notwithstanding increased activism, shareholder power is now generally exercised not directly in individual companies as it was in Veblen’s day, but indirectly on the corporate sector as a whole through financial markets. In other words, it is ubiquitous. Permanently under threat,

¹³¹ See Wolfgang Streeck, *Buying Time* (Verso, 2014).

managers have been pressed into trying to 'maximise shareholder value'. The rise of the market for corporate control has been central here. As Grahame Thompson says, 'even the largest global firms can be stalked by activist investors – hunted by private equity or sovereign wealth funds seeking added shareholder value extraction ... Few companies – however large or internationalised – are immune from the threat of takeover'. So far as corporate executives are concerned, of course, it isn't just a matter of externally imposed imperatives: modern forms of executive remuneration, designed to align the interests of managers with those of shareholders, have made the ruthless pursuit of 'shareholder value' very lucrative. With increased shareholder power and activism commonly mistaken as evidence of shareholder 'ownership', these developments have underlain the emergence of corporate schizophrenia on a grand and unprecedented scale.

The reassertion by finance of power over corporations using the residual proprietary rights of shareholders has, of course, been controversial, generating not only the emergence of markedly less 'socialised' corporations, but radically altering the balance of power between capital and labour. This has contributed to the increases in wealth inequality recently documented by Thomas Piketty and others. It is striking, however, that in the defences forwarded by academic commentators for the restoration of unambiguous shareholder primacy, reassertions of shareholder corporate 'ownership' do not figure prominently, although, as the Railtrack cases demonstrate, their common sense appeal remains strong. Aware, perhaps, that the claim that the shareholders 'own' corporations is legally unsustainable, in recent decades academic supporters of shareholder primacy have tended to downplay claims about shareholder corporate 'ownership'. Thus in the pro-shareholder nexus-of-contracts theories of the corporation which rose to prominence in the 1970s and 80s, traditional rights-based, 'ownership' defences of shareholder primacy are replaced by efficiency-based, consequentialist defences. Shareholder primacy, it is argued, benefits society as a whole by ensuring that corporations operate efficiently and that aggregate social wealth is maximised.

Despite their recognition that shareholders don't own corporations, however, in many ways nexus-of-contracts theories represent the academic apotheosis of corporate schizophrenia, for in some contexts they confirm, and indeed rely on, the existence and reality of the separate corporate person, while in others they conceptualise the corporation out of existence, dismissing it as a mere 'legal fiction'. Frank Easterbrook and Daniel Fischel, for example, begin their well-known exposition of the contractual theory by curtly dismissing the existence of the corporation as a matter of 'convenience rather than reality'. Having got the corporate entity out the way, they reconnect shareholders not only to the corporate capital and assets but to the directors, depicting them as agents not of the (non-existent) company but of the shareholders. Corporate governance thus becomes a simple 'agency problem': how do you get agent-directors to act in the interests of their shareholder-principals? However, when defending limited liability - which they describe as 'perhaps *the* distinguishing feature of corporate law' - Easterbrook and Fischel have hastily to resurrect the corporate entity. '*Corporations*', they tell us, 'do not have limited liability; they must pay all of their debts, just as anyone else must' (their emphasis).¹³² It is difficult to find a more egregious example of 'the corporation' appearing and disappearing as and when required. For these writers the ideological attractions of nexus-of-contracts theory outweigh its theoretical and empirical implausibility: in its convoluted and round-about way, it has the desired effect of restoring the corporation's capital/ assets – if not the (non-existent) corporation itself - to the status of objects of property owned by the shareholders and managed by their director-agent. The separate personhood of the corporation is taken very seriously in one context, but totally disappears – along with the corporation – in another.

CORPORATE SCHIZOPHRENIA AND THE NEW FINANCIAL ARISTOCRACY

¹³² Frank Easterbrook & Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard UP, 1991)

The defenders of shareholder primacy are aware, however, that no matter how theoretically sophisticated, consequentialist defences of shareholder rights do not have quite the same persuasive power as defences based on notions of ownership and property right. As a result, assertions of (or assumptions about) shareholder corporate 'ownership' persist not only in everyday consciousness, as the Railtrack cases show, but in the academic literature. Indeed, ownership claims loom large in defences of shareholder primacy in other ways too. The privatization of previously state-owned industries and spread of private pensions have seen ownership of financial property spread: shareholding is no longer the preserve of the very wealthy but has trickled down to ordinary people. On this basis it is often argued that shareholding has been 'democratised'; that 'we are all (more or less) shareholders now'. The implication is that shareholder primacy not only *indirectly* benefits us all by ensuring productive efficiency and the maximisation of aggregate social wealth, but *directly* benefits a growing number of us in our capacity as share-owners.

This is misleading. Although the (direct and indirect) ownership of shares and other forms of financial property has indeed spread, in recent decades it has also become increasingly concentrated amongst the very wealthy.¹³³ Piketty shows, for example, that since 1970 in the US the proportion of 'wealth' or 'capital' owned by the top 10% has risen from just over 60% to over 70%, and the proportion owned by the top 1% has risen from under 30% to over 35%. The levels of concentration are not quite as high in Europe but the pattern is similar.¹³⁴ Indeed, if anything, he may have *understated* the levels of wealth and financial property concentration in the US.¹³⁵ Piketty also traces the dramatic increase in income inequality, observing that it has been driven

¹³³ Paddy Ireland, 'Shareholder primacy and the distribution of wealth' (2005) 68 *MLR* 49.

¹³⁴ Thomas Piketty, *Capital in the twenty first century* (Belknap, Harvard UP, 2014), 346-350

¹³⁵ See, for example, Emmanuel Saez & Gabriel Zucman, *The Distribution of US Wealth, Capital Income and Returns since 1913* (March, 2013): <http://gabriel-zucman.eu/files/SaezZucman2014Slides.pdf>;

in part by the growth in ‘supersalaries’, the enormously high incomes going to corporate executives and the ‘supermanagers’ of ‘other people’s money’.¹³⁶ The result is a politically powerful alliance between the very wealthy, the managers of their money, the executive managerial class, and what Jeffrey Winters has called the ‘agents of wealth defence’ - the army of skilled professionals (lawyers, accountants and the like) employed by the wealthy to protect their incomes.¹³⁷ Indeed, Olivier Weinstein notes the detachment from corporations not only of shareholders but of the ‘new type of CEO’, who ‘no longer identif[ies] with his company’ but ‘much more with the class to which he belongs and for which financial results are the “normal” preoccupation’.¹³⁸ The identity of the ‘new aristocracy of finance’ has, then, changed since Marx’s time. It is not the small shareholders of the RPSAG but the elite owners of financial property and new elite class of executives and money managers who have been the real beneficiaries of the vigorous reassertion of shareholder primacy and the restoration and intensification of corporate schizophrenia. At no time was this clearer than during the financial crisis, when, after years of reaping plentiful financial benefits, the shareholders of the financial institutions concerned, like the shareholders of Railtrack, were seen as bearing no responsibility for the disasters wrought by the corporations they claimed to ‘own’.

RETHINKING CORPORATE RIGHTS-OBLIGATIONS STRUCTURES

The reassertion by shareholders of their residual ownership rights has led to a re-financialization of corporate governance, creating problems not only of distributional justice but of economic and

¹³⁶ Piketty, 315-335

¹³⁷ See, for example, Winters ‘Wealth Defence Industry’ (2011) http://www.alternet.org/story/154930/wealth_defense_industry%3A_the_real_reason_america's_oligarchs_can_squeeze_the_rest_of_us.

¹³⁸ Olivier Weinstein, ‘The shareholder value corporation: Between mythology and reality’, 3 *Accounting, Economic and Law* (2013) 43 at 57

social dynamics: our current institutional arrangements have generated a logic of process that not only impedes productive activity but encourages financial manipulation and excessive risk-taking. Since the financial crash of 2007-08, more and more commentators have recognised this, agreeing that the (short-term) financial focus on 'shareholder value' and emphasis on performance-related pay linked to share prices contributed to the meltdown. As a result, debates not only about corporate governance but about the nature and purpose of the corporation and the constitution of corporate rights-obligations structures have begun to re-emerge.

These debates still lack the radical edge of those of the 1920s and 30s, but there is no doubt that some of the neoliberal corporate governance orthodoxies of the 1990s are being questioned, particularly the idea that managers should try to maximise shareholder value. The attack on shareholder value, encapsulated academically by Lynn Stout's *The Shareholder Value Myth*¹³⁹, extends to the business world, exemplified by Jack Welch's assertion that it was 'the dumbest idea in the world'.¹⁴⁰ Even the *Financial Times* has joined in. The 'mess' we have made of corporate governance, the FT's Martin Wolf suggests, 'has a name: it is shareholder value maximisation'.¹⁴¹ These critiques do not, however, generally rest on a rejection of shareholder primacy. On the contrary, their goal is generally to get managers to pursue shareholder value in a more 'enlightened' manner and to focus on long- rather than short-term financial returns: to act less like industrial capitalists and more like money capitalists. Many of the reform proposals that have emerged thus seek to 'empower' shareholders and to get them to act more like 'proper', active, committed 'owners', and to engineer a change of attitude in managers in which they adopt the role of 'stewards'. Thus Colin Mayer, implicitly recognising the problem of corporate schizophrenia, seeks to supplement the traditional emphasis on 'incentives, ownership and

¹³⁹ Stout, *Shareholder Value Myth*

¹⁴⁰ Welch is the former CEO of GE and was previously seen as one of shareholder value's leading proponents.

¹⁴¹ *Financial Times*, 20/8/14

control' with an emphasis on 'obligations, responsibilities and commitment', proposing *inter alia* that voting rights be withheld from shareholders until they have shown their 'ownership' credentials and held their shares for a specified number of years.¹⁴²

What is missing from many of these critiques is recognition that the great majority of corporate shareholding is inherently passive, detached and financial in nature; and that the increasing mediation of share ownership by institutions acting as the 'general managers' of 'all lenders of money' has intensified its financial focus. Trying to get money capitalist *rentier* shareholders and their representatives to act more like proper, industrial capitalist 'owners' is rather like trying to get cats to bark. Indeed, as Lorraine Talbot has pointed out, reforms aimed at trying to empower *rentier* shareholders and make them more active, whether in financial markets or in the corporations themselves, are more likely to exacerbate the problem, not solve it.¹⁴³ Although proposals such as Mayer's for time-dependent voting rights are, then, steps in the right direction and highlight the need to make changes to corporate rights-obligation structures, it has to be questioned whether they go far enough. They don't address the underlying problem: the Janus-faced, hybrid nature of corporate shareholding – its 'novel status'¹⁴⁴ - which underlies our schizophrenic treatment of the corporation as 'completely separate' from its shareholders for some (liability) purposes but as an object of property 'owned' by them for others. In an institutional context in which money capital is increasingly concentrated in the hands of a small elite and is managed by powerful financial institutions, this is proving a toxic mix. By combining no-liability *rentier* shareholding with control rights, by mixing (insider) rights *in rem* with (outsider) rights *in personam*, our rights-obligations structures have become a recipe not only for short-termist financialized governance, but for managerial excess, corporate rapacity and irresponsibility, the

¹⁴² Colin Mayer, *Firm Commitment* (OUP, 2013), 6, 246-8. This underpins his proposed solution: 'trust companies'.

¹⁴³ Lorraine Talbot, 'Why Shareholders Shouldn't Vote', 76 *MLR* (2013), 791.

¹⁴⁴ Flannigan, *JBL* 6.

increasing exploitation of labour by capital, and growing inequality. The problem is not merely one of ‘commitment’: the members of RPSAG were long-term, committed shareholders, but they lacked any liability and sense of responsibility for Railtrack’s behaviour.

We need, then, to look hard at our legal organisational forms. As the Railtrack cases confirm, the ‘contractual right [of shareholders] to receive profit on a residual basis ... along with rights to elect and remove directors ... appears to suggest to some that shareholders remain the “real owners” of the business and therefore ought to enjoy that status *whenever it suits their purposes*’. It also ‘constitutes a direct rejection of the entity status of the corporation’, upon which, of course, in other (liability) contexts, shareholders rely.¹⁴⁵ In the specific context of the large, *rentier*-dominated, public corporations that dominate so many areas of productive activity, there is an urgent need to reconsider the Janus-faced, hybrid nature of corporate shareholding and to take separate corporate personhood really seriously. This might enable us to tap the ‘yet unrealized potential of the corporation’.¹⁴⁶ Radical reform of corporate rights-obligations structures will, of course, require us to dispel the myth of shareholder ownership and the ideological and intellectual barriers to this are considerable. Although Mayer is keen to emphasise that companies are entities with a separate legal existence of their own, he still refers to corporate shareholders as ‘owners’.¹⁴⁷ And when Lynn Stout discussed her book on New York City Radio recently, ‘the interviewer simply couldn’t get his mind around [her] claim that shareholders aren’t really “owners”’.¹⁴⁸

The political obstacles to reform are, of course, even greater. The enormous power and influence of the new financial oligarchy means that reform (even of the Mayer type) is going to be

¹⁴⁵ Flannigan, *JBL*, 10 (emphasis added).

¹⁴⁶ Mayer, 241

¹⁴⁷ Mayer, 22, 242.

¹⁴⁸ <http://www.thedeal.com/thedealeconomy/lynn-stouts-the-shareholder-value-myth.php>

vigorously opposed and resisted, as are the shifts in understandings and consciousness that are needed. But there are some promising signs: the characterisation and treatment of shareholders as ‘owners’ is once again actively and widely being questioned, and the issue of worker participation is beginning to re-emerge as a live issue.¹⁴⁹ In this more open intellectual environment, the historical development of the corporate legal form and the old debates surrounding corporate shareholding are worth revisiting, for they not only force us to question the hybrid status of corporate shareholders – ‘owed’ or ‘owning’?¹⁵⁰ – but remind us just how contingent, complex and malleable are the institutions of property and ownership. The rights in the property bundle can be allocated and arranged in many different ways. Not everything has to be ‘owned’ in the full liberal sense; nor is it always better if they are. As Mayer says, ‘there is no natural order ... we can create concepts and institutions to assist rather than subjugate us’.¹⁵¹ The range of institutional possibility is much wider than often realised: the choice is not simply between private property and collective property, or markets and government.¹⁵² It is time we began to experiment with different rights-obligations structures and what Berle called new ‘schemes of responsibility’, and to address the problem of institutional know-how he identified all those years ago.

14238 words, excluding footnotes; 17257 including footnotes.

¹⁴⁹ [http://www.centreforum.org/index.php/mainpublications/292-employee-empowerment;
http://policy.greenparty.org.uk/wr.html](http://www.centreforum.org/index.php/mainpublications/292-employee-empowerment;http://policy.greenparty.org.uk/wr.html)

¹⁵⁰ <https://themoderncorporation.wordpress.com/company-law-memo/>

<https://themoderncorporation.wordpress.com/economics-and-msv/>

¹⁵¹ 255

¹⁵² See Roberto Unger, *The Left Alternative* (Verso, 2009).